

BEFORE THE
TENNESSEE STATE BOARD OF EQUALIZATION

<i>In Re:</i>	Economy Pencil Company, Inc.)	
	District 7, Map 78, Control Map 78,)	
	Parcel 43.01P, Special Interest 001)	Bedford County
	Back Assessment/Reassessment)	
	Tax year 2006)	

INITIAL DECISION AND ORDER

Statement of the Case

This is a direct appeal to the State Board of Equalization ("State Board") pursuant to Tenn. Code Ann. section 67-1-1005(b) from the following back assessment/reassessment of the subject property:

Original Assessment	Revised Assessment	Back Assessment/ Reassessment
\$104,087	\$978,938	\$874,851

The appeal was hand-delivered to the State Board on September 26, 2007. On December 14, 2007, Robert T. Lee, Attorney for the State Division of Property Assessments (DPA), filed a petition for intervention on DPA's behalf.

The undersigned administrative judge conducted a hearing of this matter on December 19, 2007 in Shelbyville. The appellant, Economy Pencil Company, Inc. ("Economy Pencil"), was represented by Stephen J. Jasper, Esq., of Bass, Berry & Sims (Nashville). Bedford County Assessor of Property Ronda Helton Clanton was assisted by Mr. Lee, whose petition for intervention was granted without objection.

Findings of Fact and Conclusions of Law

Background. Founded in 1946, Economy Pencil is a supplier of promotional office products (e.g., pencils; pens; calculators; rulers; staplers) marketed under the trade name “Jo-Bee.” Exhibits 1—3. Some 65 persons are employed in the company’s Shelbyville plant, which encompasses three structures: an office building; production area; and warehouse. Economy Pencil sells its wares exclusively through a network of several thousand distributors, most of whom are located in North America.

The bulk of the items that make up Economy Pencil's inventory are pre-assembled by the various manufacturers. In a typical year, about 15-20% of the stock consists of component parts that must be assembled by the company's personnel on site (with automated equipment or manually). The inventory is stored mainly in the warehouse; some items are kept in the production area for quicker response to small orders.

As explained by co-owner/president Allen Pitner, Economy Pencil customizes generic office products by imprinting on them a logo, trademark, artwork, or other identifying information in conformity with the ultimate consumer's specifications. The company performs this function primarily by means of a *silk-screen process*: i.e., "a method of producing a stencil in which a design is imposed upon a screen of silk or other fine fabric, with blank areas coated with an impermeable substance, and ink is forced through the cloth onto the printing surface." *The American Heritage Dictionary* (Second College Edition, 1985), p. 1140. Depending on the characteristics of the item, another method ("pad printing," "hot stamping," or "laser engraving") may be utilized.

Economy Pencil occasionally sells products to its customers (distributors) in the same unmarked state as received from the manufacturer. Such sales usually account for less than 10% of the total annual volume.

Bedford County Clerk Kathy Prater testified that Economy Pencil is considered to be exempt from the Business Tax Act (Tenn. Code Ann. sections 67-4-701 *et seq.*) as a "manufacturer."¹

Stipulations. After the hearing, the parties submitted written Stipulations which are attached to this initial order and incorporated herein by reference.

Contentions of the Parties. As recited in Stipulations 5 and 6, the only remaining bone of contention in this appeal concerns the products and component parts that were picked up as "raw materials" in the audit of the subject account. Economy Pencil asserts that these unreported items are tax-exempt "inventories of merchandise held by merchants and businesses for sale and exchange" within the meaning of Tenn. Code Ann. section 67-5-901(b). The Assessor and DPA maintain that such property is used (or held for use) by the company in what amounts to a manufacturing process.

Applicable Law. Article II, section 28 of the Tennessee Constitution states that "all property real, personal or mixed shall be subject to taxation" unless exempted by the legislature.

The assessment of tangible personal property in this state is governed by Tenn. Code Ann. sections 67-5-901 *et seq.* In relevant part, Tenn. Code Ann. section 67-5-901(a) reads as follows:

...[A]ll tangible personal property, except inventories of merchandise held by merchants and businesses for sale and

¹In her official capacity, Ms. Prater is a local administrator of the Business Tax Act. Tenn. Code Ann. section 67-4-712(b)(2) exempts from the Act "[a]ny person primarily engaged in the manufacture of goods, wares, merchandise or other articles of value from a location or outlet subject to ad valorem taxation under the provisions of chapter 5, part 5 of this title."

exchange **by persons taxable under chapter 4, part 7 of this title** (the Business Tax Act), and unused tangible personal property shall be classified according to its use and assessed as follows:

...
(2) Industrial and commercial property shall be assessed at thirty percent (30%) of its value...[Emphasis added.]

All business or professional entities must submit annually to the assessor on the prescribed form a complete list of the tangible personal property used (or held for use) in their business or profession, excluding *inventories of merchandise held for sale or exchange*. Tenn. Code Ann. section 67-5-903. As defined in Tenn. Code Ann. section 67-5-901(b), that term “includes tangible personal property held for sale or rental, but does not include such property in the possession of a lessee.”

The General Assembly has expressed the intent that inventories of merchandise held for sale or exchange, which are taxable under the Business Tax Act, not be subject to ad valorem taxation.² Tenn. Code Ann. section 67-4-701.

Among the types of fixed assets which are reportable under Tenn. Code Ann. section 67-5-903 are *raw materials* – defined in State Board Rule 0600-5-.01(8) as “items of tangible personal property, crude or processed, which are held or maintained **by a manufacturer** for use through refining, combining, or other process in the production or fabrication of another item or product.” [Emphasis added.]

Analysis. By definition, then, raw materials are assessable as such only if they are held for use by a *manufacturer*. Resolution of this dispute is somewhat hindered by: (a) the lack of any statutory or regulatory definition of the word “manufacturer” for personal property tax purposes; and (b) the paucity of authoritative precedent on the question of what constitutes the “production or fabrication of another item or product.”³

Clearly, however, Economy Pencil is engaged in manufacturing at least to the extent that the company assembles those items which are received as component parts. This conclusion is not negated by the relative simplicity of such operation, which undeniably results in the creation of a new and – in Mr. Jasper’s words – “fully functional” product. Hence the “pen components” having a stipulated value of \$149,522.28 were properly assessed to the taxpayer as raw materials.

²The definition of “inventories of merchandise held for sale or exchange” in section 67-4-702(9) of the Business Tax Act is substantially the same as that in Tenn. Code Ann. section 67-5-901(b).

³It should be noted that whatever instructions may have been furnished by the Assessor (or DPA) to assist taxpayers in completing and filing the prescribed tangible personal property form do not have the force and effect of law. See Ezon Products, Inc. (Shelby County, Tax Year 1996, Final Decision and Order, February 14, 2000).

Whether the silk-screening and other processes applied to Economy Pencil's pre-assembled inventory make the company a "manufacturer" within the purview of State Board Rule 0600-5-.01(8) poses a more difficult question. To be sure, unlike the modifications to motor vehicles that were involved in The Sully Corporation (Shelby County, Tax Years 2003, 2004, Initial Decision and Order, July 28, 2006), these printing processes do not alter the form, shape, or performance of any item. But they do unmistakably alter the *appearance* of the products in such a way as to enhance their economic utility and value to the ultimate consumers. According to *Black's Law Dictionary* (6th ed. 1990):

(The) meaning of (the) word "manufacture," which is defined as the making of goods or wares by manual labor or by machinery, especially on a large scale, has expanded as workmanship and art have advanced, so that now nearly all artificial products of human industry, **nearly all such materials as have acquired changed conditions** or new and specific combinations, whether from the direct action of the human hand, **from chemical processes devised and directed by human skill**, or by the employment of machinery, are commonly designed as "manufactured." [Emphasis added.]

Id. at pp. 964-65.

Arguably, in the Ezon case cited by counsel for the appellant, the Assessment Appeals Commission erred in classifying the labeled packaging materials at issue as "inventories of merchandise held for sale or exchange" in the hands of a wholesaler who did not even offer them for sale separately. In any event, the Ezon decision hardly forecloses the possibility that items which are "already finished products, completely functional, usable, and ready for sale to customers" (Pre-Hearing Brief of Economy Pencil, p. 7) may themselves be used in the fabrication of *another* product. In fact, that was the situation in The Sully Corporation case.⁴

In the opinion of the administrative judge, the imprinting of pencils, pens, and other office products by means of a fairly sophisticated silk-screen or other process does result in the creation of visibly distinct articles of commerce. Indeed, Economy Pencil's own admission that the screens, solvents, inks, and other substances used in those operations are assessable (as raw materials) seems to undercut the claim that they do not rise to the level of manufacturing. Exhibit 8.

Moreover, contrary to the suggestion in Economy Pencil's Post-Hearing Brief (p. 3), the administrative judge cannot ignore the company's apparent exemption (as a manufacturer) from the Business Tax Act. The courts have consistently held that the Business Tax Act and the provisions of Tenn. Code Ann. sections 67-5-901 *et seq.* must be construed *in pari materia*. See, e.g., IBM Credit Corporation v. County of Hamilton, 830 S.W.2d 77 (Tenn.App. 1992). Acceptance of the appellant's position in this proceeding would lead to the anomalous result that the property in question would generate neither gross receipts nor ad valorem taxes.

⁴The taxpayer has taken exception to the initial order in The Sully Corp., which is still pending before the Assessment Appeals Commission.

Order

It is, therefore, ORDERED that the following values be adopted for tax year 2006:

Revised Assessment	Back Assessment/ Reassessment
\$390,817	\$286,730

Pursuant to the Uniform Administrative Procedures Act, Tenn. Code Ann. §§ 4-5-301—325, Tenn. Code Ann. § 67-5-1501, and the Rules of Contested Case Procedure of the State Board of Equalization, the parties are advised of the following remedies:

1. A party may appeal this decision and order to the Assessment Appeals Commission pursuant to Tenn. Code Ann. § 67-5-1501 and Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization. Tennessee Code Annotated § 67-5-1501(c) provides that an appeal **“must be filed within thirty (30) days from the date the initial decision is sent.”** Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization provides that the appeal be filed with the Executive Secretary of the State Board and that the appeal **“identify the allegedly erroneous finding(s) of fact and/or conclusion(s) of law in the initial order”**; or
2. A party may petition for reconsideration of this decision and order pursuant to Tenn. Code Ann. § 4-5-317 within fifteen (15) days of the entry of the order. The petition for reconsideration must state the specific grounds upon which relief is requested. The filing of a petition for reconsideration is not a prerequisite for seeking administrative or judicial review.

This order does not become final until an official certificate is issued by the Assessment Appeals Commission. Official certificates are normally issued seventy-five (75) days after the entry of the initial decision and order if no party has appealed.

ENTERED this 18th day of January, 2008.



PETE LOESCH
ADMINISTRATIVE JUDGE
TENNESSEE DEPARTMENT OF STATE
ADMINISTRATIVE PROCEDURES DIVISION

cc: Stephen J. Jasper, Attorney, Bass, Berry & Sims PLC
Robert T. Lee, General Counsel, Comptroller of the Treasury
Ronda Helton Clanton, Bedford County Assessor of Property

**TENNESSEE STATE BOARD OF EQUALIZATION
BEFORE THE ADMINISTRATIVE JUDGE**

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In Re: Economy Pencil Company, Inc.
District 7, Map 63, Control Map 78
Parcel 43.01P, Special Interest 001
Back Assessment / Reassessment
Tax Year 2006

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TP. ST. BD EQUALIZATION

Bedford County

STIPULATIONS

Comes now the Bedford County Assessor of Property, Division of Property Assessments, and Taxpayer and stipulate to the following:

1. The audit of the Taxpayer that gave rise to the Back Assessment at issue in this appeal determined the following adjustments were appropriate for Tax Year 2006 (excluding Group 8 –Raw Materials & Supplies property):

Group 1	\$	181.00
Group 2	\$	(211.00)
Group 5	\$	4,108.00
Leased	\$	(19,429.00)
Total Adjustment without Group 8	\$	(15,351.00)

2. The parties do not dispute the appropriateness of the adjustments identified in the prior paragraph. Instead, the issue in this appeal is the adjustment reflected in the Back Assessment with regard to the value of the Taxpayer's Group 8 property for Tax Year 2006. Accordingly, the property at issue in this appeal is the Taxpayer's property – in addition to the property the Taxpayer previously reported as Group 8 property – that the Back Assessment treats as Group 8 property.
3. The Taxpayer reported \$5,757 in Group 8 property (Raw Material & Supplies) for Tax Year 2006.
4. The Back Assessment at issue in this appeal is based on a determination that the actual value of the Taxpayer's Group 8 property for Tax Year 2006 was \$2,937,728. The parties agree that this determination of value was based on erroneous information.

5. Of the property at issue in this appeal, it is undisputed that the Taxpayer held Group 8 property with the following value for Tax Year 2006:

Undisputed Raw Material	\$	19,730.39
Undisputed Supplies	\$	<u>13,242.20</u>
Total	\$	32,972.59

See Exhibit 8

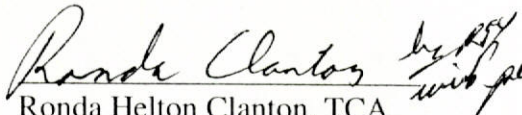
6. The property at issue in this appeal, about which the parties have a dispute regarding whether it is properly classified as Raw Materials, had the following value for Tax Year 2006:

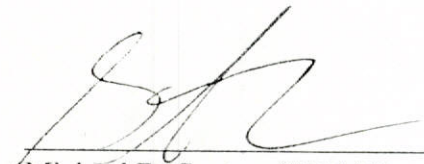
Inventory Received Fully Assembled	\$	773,273.16
Pen Components	\$	<u>149,522.28</u>
Total	\$	922,795.44

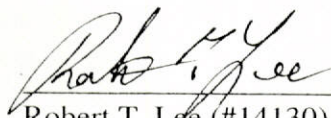
See Exhibit 8

7. The property at issue in this appeal that is located in the Taxpayer's production area should be considered work-in-process and not reported or assessable. For Tax Year 2006, the value of such property totaled \$123,151.10.
8. The property at issue in this appeal that is located in the Taxpayer's shipping area should be considered finished product and not reported or assessable. For Tax Year 2006, the value of such property totaled \$5,089.47.
9. Although the Taxpayer sells some of its inventory "as is" – that is, without placing any identifying information or other label onto the product – those sales typically comprise no more than 10% of the Taxpayer's sales. In Tax Year 2006, the Taxpayer sold no more than 10% of its inventory "as is."
10. As reflected in the prior stipulations, the parties agree that the Back Assessment at issue in this appeal was based on erroneous information which resulted in an excessive Back Assessment and should be revised. At a maximum, the Back Assessment should be revised to reflect a \$955,768.03 increase in the value assigned to the Taxpayer's Group 8 property from that which was reported by the Taxpayer for Tax Year 2006. At a minimum, the Back Assessment should be revised to reflect a \$32,972.59 increase in the value assigned to the Taxpayer's Group 8 property from that which was reported by the Taxpayer for Tax Year 2006.

Approved:


Ronda Helton Clanton, TCA
Bedford County Assessor of Property


Michael D. Sontag (#11142)
Stephen J. Jasper (#22861)
Attorney for Taxpayer


Robert T. Lee (#14130)
Attorney for Division of Property Assessments